Monday, August 26, 2024

SUMMARY-

I. Market rebound continues for second straight week.

II. Fed confirms upcoming policy shift at Jackson Hole.

III. Inflation still above target while focus turns to employment.

IV. Stocks historically respond positively to rate cuts when not in a recession.

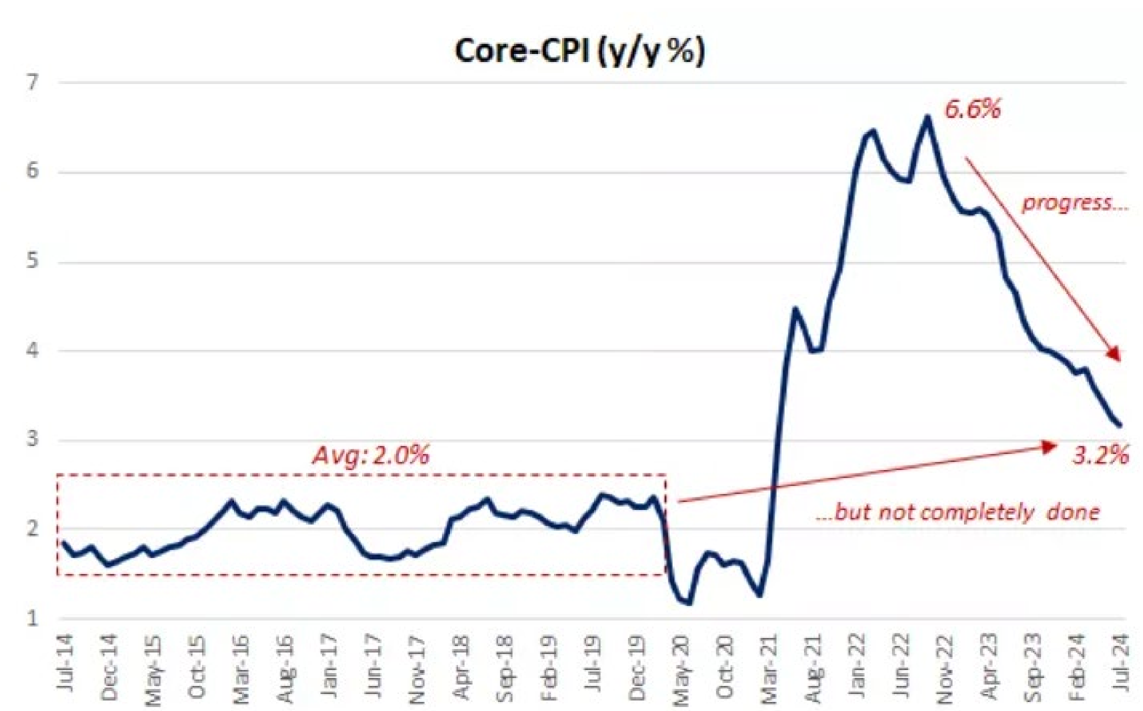
Good morning:

Major large-cap stock averages added about 1.4% last week to extend the prior week's gains, now recovering nearly all the ground it lost in the stretch of elevated volatility in late July and early August. Confirming and punctuating the continued comeback was Friday's remarks from Fed Chairman Jerome Powell at the Federal Reserve's annual economic symposium in Jackson Hole, Wyoming. The market's long wait for rate cuts to commence is nearing an end as Powell declared, "the time has come for policy to adjust," reinforcing expectations for an initial rate cut at the Fed's next meeting ending September 18th.

After keeping rates steady since pausing the aggressive tightening campaign more than a year ago, inflation has continued its descent. Although Core CPI is still well above the Fed's 2.0% target at 3.2%, it has now declined for four straight months and sits at the lowest reading since April 2021. Clearly, the

Fed's policy shift indicates they are comfortable that inflation's trajectory will continue downward and not suddenly reverse course. For this reason, we anticipate a more cautious rate reduction plan of measured 0.25% cuts while economic data is closely monitored for any signs of adverse effects.

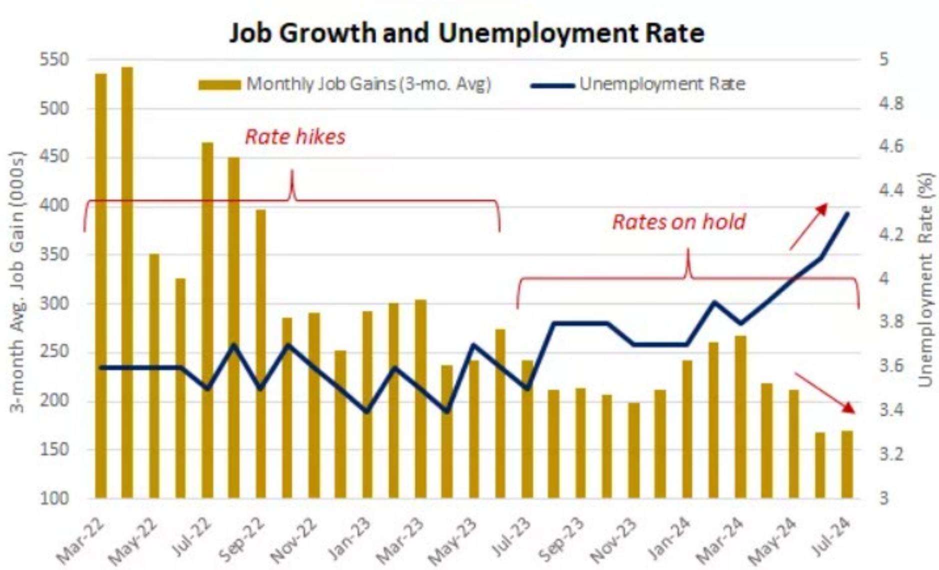
Inflation has moderated, but there's more work to do.



Source: Bloomberg

The fact that the U.S. economy has remained resilient during this extended period of hyper-inflation and aggressive rate hikes is historically remarkable. Most economists predicted a recession was, if not inevitable, far more likely than the so-called "soft landing" that now appears to have been achieved. The tightrope that the Fed has had to walk trying to tackle inflation while not toppling the economy, however, still has farther to go. July's underwhelming jobs report (in which monthly hiring slowed and the unemployment rate ticked up to its highest since October 2021) set off a rash of recession worries a few weeks ago, which sparked the early-August sell-off in stocks. While this recession panic now appears overblown, it may have helped the Fed to remember it has a dual mandate: stable prices *AND* full employment. Most economists do not think a recession is on our doorstep, but some emerging cracks in our otherwise incredibly solid labor market do warrant the Fed's attention. We will look for upcoming rate decisions to reflect the Fed's effort to support a more material deterioration in employment conditions and as they attempt to stave off a more meaningfully economic slowdown.

Recent softness in labor market supports the shift in Fed policy.



Source: Bloomberg

Markets have been anticipating lower interest rates since the Fed's final hike in July 2023. As equities generally perform well during periods of declining rates, some of our current bull market run can be attributed to investors pricing in the easier monetary policy to come. However, with the economy and corporate earnings still growing, falling interest rates could provide a tailwind for equities to continue their march higher.

Fed Rate Hikes 2022-2023: Taming Inflation

FOMC Meeting Date	Rate Change (bps)	Federal Funds Rate
July 26, 2023	+25	5.25% to 5.50%
May 3, 2023	+25	5.00% to 5.25%
March 22, 2023	+25	4.75% to 5.00%
Feb 1, 2023	+25	4.50% to 4.75%
Dec 14, 2022	+50	4.25% to 4.50%
Nov 2, 2022	+75	3.75% to 4.00%
Sept 21, 2022	+75	3.00% to 3.25%
July 27, 2022	+75	2.25% to 2.50%
June 16, 2022	+75	1.50% to 1.75%
May 5, 2022	+50	0.75% to 1.00%
March 17, 2022	+25	0.25% to 0.50%

Source: Forbes

Some rate cutting cycles in recent history have come in response to weaker economic data. Others, though, were in response to a major shock to our financial system. This was the case in 2020 after the COVID-19 shutdown, in 2007 after the global financial crisis, and in 2001 after 9/11. As the chart below shows, in periods like 1987, 1995, and 1998 when rate cuts were not accompanied by an ensuing recession, equity returns in the following 1 and 2 years were particularly strong. However, when the shock that precipitated the rate cuts triggered a recession like in 2001 and 2007, markets still posted significant losses. Therefore, barring any unforeseen shocks to the economy, we see the forthcoming rate cut cycle as supportive to further gains in equities, although investors should anticipate continued periods of heightened volatility as we go through this policy transition.

Broader market performance following initial rate cuts has often been positive.

	Stock Market Return:	
First Rate Cut	1 year later	2 years later
Sep. 1984	8.6%	39.1%
Nov. 1987	18.8%	50.2%
Jun. 1989	6.5%	20.1%
Jul. 1995	18.7%	72.9%
Sep. 1998	22.5%	40.4%
Jan. 2001	-12.4%	-30.6%
Sep. 2007	-18.9%	-26.3%
Aug. 2019	12.0%	52.8%

Source: Bloomberg

In addition to important inflation and GDP data this week, markets will also be watching for the earnings results and forward-looking guidance on Wednesday from NVIDIA, Magnificent Seven member and leading A.I. chip maker. After its recent significant appreciation, NVIDIA represents an outsized weighting in all market-cap-weighted indices like the S&P 500 making its results potentially market-moving to the broader averages. Regardless of how the markets interpret a single company's quarterly results, artificial intelligence, and its potential impact on all areas of our global economy will continue to remain a major theme for investors for the foreseeable future.

Have a great week!

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Market return and statistical data obtained from: https://am.jpmorgan.com/blob-gim/1383452890099/83456/weekly_market_recap.pdf?segment=AMERICAS_US_ADV&locale=en_US

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